VZCZCXRO2738
PP RUEHDA
DE RUEHAK #6734/01 3561511
ZNR UUUUU ZZH
P 221511Z DEC 06
FM AMEMBASSY ANKARA
TO RUEHC/SECSTATE WASHDC PRIORITY 0410
INFO RUCPDOC/USDOC WASHDC PRIORITY
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RUEHIT/AMCONSUL ISTANBUL PRIORITY 1844
RUEHDA/AMCONSUL ADANA PRIORITY 1461

UNCLAS SECTION 01 OF 03 ANKARA 006734

SIPDIS

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: ECON EINV BEXP KIPR TU
SUBJECT: TURKEY FDI: GROWING BUT GREENFIELD LAGS

REF: A) ANKARA 5625 B) ISTANBUL 2095

¶1. Summary: (SBU) Foreign direct investment (FDI) in Turkey has increased dramatically in the last two years, but greenfield investment still lags far behind. Analysts cite the need for judicial reform, Turkey's large informal economy, high employment taxes and costs, the large indirect tax burden, the need for educational reform, weaker protection of IPR, and a perceived judicial and regulatory bias for domestic companies as factors holding back Greenfield investment. Turkey has made a number of improvements and is pursuing several structural reforms to address these deterrents to investment. High levels of FDI, including job-creating and technology-transferring greenfield investments, are necessary if Turkey is going to achieve the high investment rates that will be needed over the next decade for living standards to catch-up and converge with EU levels. End summary.

FDI INCREASING DRAMATICALLY BUT GREENFIELD LAGGING

¶2. (SBU) Foreign direct investment (FDI) in Turkey continues to increase dramatically. In stark contrast to cumulative investment of only $17 billion for the previous fifteen years, Turkey received a total of $9.7 billion in FDI inflows in 2005 alone. This trend has continued in 2006, with $15.3 billion in inflows in the first ten months. Political stability, economic growth and reductions in bureaucratic red tape are the main attractors of new investment. Analysts cite Turkey's much lower inflation rate, recently-acquired EU accession country status, attractive demographics and opportunities in particular sectors, such as banking, telecoms and retail, as well as the abolition of investment screening in 2003. Turkey's privatization program also created opportunities for foreign direct investors, notably the $6.5 billion privatization of the state telecoms company, Turk Telekom.

¶3. (SBU) But very little of this new FDI (only $1.7 billion in 2005) has come in the form of investment in new plant and equipment, as most goes to privatizations and mergers and acquisitions. This lack of greenfield investment is of increasing concern to economists and government officials, who fear the economy is missing out on the job creation and technology transfer that comes with it. Economy Minister Babacan and other senior officials are aware of this deficiency and say they hope to attract more greenfield investment, especially in growing sectors like energy and information technology.

INVESTMENT-STIMULATING REFORMS PROPOSED

¶4. (SBU) Several factors account for the small amount of Greenfield investment in Turkey: an inefficient judicial system, a large unrecorded economy, high employment taxes and costs, a large indirect tax burden (such as taxes on telecom, fuel, and electricity

consumption), and a need for educational reforms to spur research and innovation. In response to the need for judicial reforms, the GOT has proposed or is in the process of implementing a number of measures that it hopes will improve the speed and reliability of judicial administration. These include an e-justice initiative that should significantly speed the processing of commercial cases. Another improvement is ongoing training, with EU support, for judges and prosecutors to familiarize them with modern commercial issues such as IPR protection. In addition to this training, the EU, the World Bank, and the U.S. are supporting improved access to justice for foreign investors, including legal aid and Alternative Dispute Resolution mechanisms. The GOT has also proposed the creation of an intermediary level of regional appeals courts and is building new courthouses to ease overcrowding.

¶5. (SBU) The government also plans to reform Turkey's antiquated Commercial Code, which was created in 1957. The new Code aims to simplify rules for company formation (which will ease shareholder and capital requirements), simplify merger procedures, provide clearer definition of responsibilities of Boards of Directors, create independent audit requirements, and link Turkish accounting standards to International Accounting Standards.

¶6. (SBU) In order to truly attract FDI, Turkey must tackle the persistent problem of its informal economy. Currently, approximately 53 percent of Turkey's workforce is in the informal economy, creating unfair competition for those companies that choose to follow the rules and register their workers. At a recent OECD Global Conference on Investment (ref B), Turkey World Bank Country Director, Andrew Vorkink called this phenomenon "the cancer of the informal economy." In his opinion, the only way for Turkey to bring more companies and workers into the formal economy is through fiscal reforms that incentivize companies to register their workers. The Bank is currently in consultations with the government on a package

of labor market reforms, including reducing high payroll taxes and severance costs. These reforms would result in attracting more Greenfield investment by evening the playing field between foreign and domestic firms.

¶7. (SBU) A recent OECD report stated that Turkey's overall corporate governance outlook is positive because the authorities have already adopted, or are introducing, high quality corporate governance standards (including audit standards) and because transparency has improved significantly. The report cautions, however, that it is important for Turkey to improve further in the areas of control and disclosure of related party transactions and self-dealing, the protection of minority shareholders, and the role of the board in overseeing not only management but also controlling shareholders.

-- ----
NEW ORGANIZATIONS PUSHING FOR IMPROVED INVESTMENT
-- ----

¶8. (SBU) Multinational companies operating in Turkey also point to Turkey's less than stellar track record for protecting International Property Rights (IPR) as a deterrent to new Greenfield investment. In response to continuing concerns about trademark violating products currently in the Turkish market or transiting through Turkey, 13 Turkish and multinational companies, including Nestle and Pfizer, have begun cooperating in the "Trademark Protection Counterfeiting Initiative." The group advertises the cost of fakes and is pushing for a new law protecting brands. They estimate that the total value of the fake market in Turkey is approximately $2.6 billion.

¶9. (SBU) Until recently, Turkey also lacked a central point of contact from which interested foreign investors could receive information and assistance in establishing a business. In response to this, the GOT recently created a new "Investment Promotion Agency" within the Prime Minister's Office. The agency's main objectives will be to "handhold" new investors throughout the establishment process and solve problems that arise after establishment. It will advocate within the government for reforms

that promote investment, and it will also work to raise public awareness of the benefits of investment. Turkey's Treasury Undersecretariat has also developed a user friendly investment website that provides users with information about investing in Turkey (including detailed regional information) and links to the various agencies from whom potential investors will need to receive information.

NORMAL PROGRESS OR BEHIND THE CURVE?

¶10. (SBU) Economic officers from the Ankara's diplomatic corps discussed Turkey's economic future at a recent working lunch. They asked Memduh Akcay, Director General for Foreign Economic Relations at the Treasury Undersecretariat, why Turkey has not seen more Greenfield investment. Akcay argued that Turkey is following the pattern of most developing nations and that it is normal to see mergers and acquisitions come first in a stabilizing market, followed by true Greenfield investment as the economy matures. Christian Keller, Deputy IMF representative in Ankara, agreed with Akcay and expressed the IMF's pleasure with the recent increase in investment inflows to Turkey.

WHY SO LITTLE GREENFIELD INVESTMENT?

¶12. (SBU) Comment: While Turkey's overall investment climate is improving, the government cannot relax reform efforts if it hopes to attract substantial greenfield investment to Turkey. Turkey needs such investment to create jobs for its unemployed and underemployed workforce and to ease the hardships created by recent losses experienced in the textile and agricultural sectors. The hardships faced by such Greenfield investors as Cargill (ref A), and continuing IPR issues could also discourage U.S. investors from giving Turkey serious consideration as a viable place to invest. In addition, while technical reforms are crucial, a change in the overall system to reform Turkey's educational system (in order to prepare workers for high-tech jobs) and stymie the problematic informal economy is needed to attract foreign companies to Turkey.

¶13. (SBU) Comment cont'd: The track record of foreign multinationals in all but a few cases preferring to enter the market by partnering with a local blue chip suggests foreign companies are yet to be convinced they will get a fair shake from Turkey's judiciary or other authorities. It is clear that a core group of government and private-sector officials are working to implement the changes needed to realize the administration's goals of increased

investment. What is also clear, however, is that Turkey's traditional distrust of foreign companies, desire to protect its domestic markets, bureaucratic and nontransparent judicial system and inability to reduce its informal sector have discouraged foreign investors from coming here. The government has made positive steps, but it must continue to do so in order to attract the 8-10% annual investment rates that the World Bank and others estimate are necessary to raise per capita income and keep it operating as a player in the global economy. End comment.
Wilson